



Testimony of

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on Behalf of

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“The Impact of Financial Regulatory Restructuring on Small Businesses”

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Introduction

Good afternoon, Chair Velazquez, Ranking Member Graves and Members of the Committee. My name is Dawn Donovan and I am testifying today on behalf of the National Association of Federal Credit Unions (NAFCU). I serve as the President and CEO of Price Chopper Employees Federal Credit Union, headquartered in Schenectady, New York. I have been with Price Chopper Employees FCU for the last 15 years. I currently serve on the NAFCU Regulatory Committee and am a past member of NAFCU's Legislative Committee. PCE FCU is a single sponsor credit union serving employees of Price Chopper Supermarkets in the Northeast. PCE FCU has approximately 4,500 members and just over \$19 million in assets.

NAFCU is the only national organization exclusively representing the interests of the nation's federally-chartered credit unions. NAFCU-member credit unions collectively account for approximately 65.4 percent of the assets of all federally chartered credit unions. NAFCU and the entire credit union community appreciate the opportunity to participate in this discussion regarding how financial regulatory restructuring will impact America's credit unions.

Historically, credit unions have served a unique function in the delivery of necessary financial services to Americans. Established by an act of Congress in 1934, the federal credit union system was created, and has been recognized, as a way to promote thrift and to make financial services available to all Americans, many of whom would otherwise have limited access to financial services. Congress established credit unions as an alternative to banks and to meet a precise public need—a niche credit unions fill today for nearly 92 million Americans. Every credit union is a

cooperative institution organized “for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.” (12 USC 1752(1)). While over 75 years have passed since the *Federal Credit Union Act* (FCUA) was signed into law, two fundamental principles regarding the operation of credit unions remain every bit as important today as in 1934:

- credit unions remain totally committed to providing their members with efficient, low-cost, personal financial service; and,
- credit unions continue to emphasize traditional cooperative values such as democracy and volunteerism.

Credit unions are not banks. The nation’s approximately 7,800 federally insured credit unions serve a different purpose and have a fundamentally different structure than banks. Credit unions exist solely for the purpose of providing financial services to their members, while banks aim to make a profit for a limited number of shareholders. As owners of cooperative financial institutions united by a common bond, all credit union members have an equal say in the operation of their credit union—“one member, one vote”—regardless of the dollar amount they have on account. These singular rights extend all the way from making basic operating decisions to electing the board of directors—something unheard of among for-profit, stock-owned banks. Unlike their counterparts at banks and thrifts, federal credit union directors generally serve without remuneration—a fact epitomizing the true “volunteer spirit” permeating the credit union community.

Credit unions have grown steadily in membership and assets, but in relative terms, they make up a small portion of the financial services marketplace. Federally-insured credit unions have approximately \$813.4 billion in assets as of year-end 2008. By contrast, Federal Deposit Insurance Corporation (FDIC) insured institutions held \$13.9 trillion in assets and last year grew by an amount exceeding the total assets of credit unions. The average size of a federal credit union is \$92.5 million, compared with \$1.673 billion for banks. Over 3,200 credit unions have less than \$10 million in assets. The credit union share of total household financial assets is also relatively small, at just 1.4 percent as of December 2008.

Size has no bearing on a credit union's structure or adherence to the credit union philosophy of service to members and the community. While credit unions may have grown, their relative size is still small compared with banks. Even the world's largest credit union, with \$36.4 billion in assets, is dwarfed by the nation's biggest banks with trillions of dollars in assets.

America's credit unions have always remained true to their original mission of "promoting thrift" and providing "a source of credit for provident or productive purposes." In fact, Congress acknowledged this point when it adopted the *Credit Union Membership Access Act* (CUMAA – P.L. 105-219) a decade ago. In the "findings" section of that law, Congress declared that "[t]he American credit union movement began as a cooperative effort to serve the productive and provident credit needs of individuals of modest means ... [and it] continue[s] to fulfill this public purpose."

Credit unions continue to play a very important role in the lives of millions of Americans from all walks of life. As consolidation of the commercial banking sector has progressed, with the resulting depersonalization in the delivery of financial services by banks, the emphasis in consumers' minds has begun to shift not only to services provided, but also—more importantly—to quality and cost. Credit unions are second-to-none in providing their members with quality personal financial services at the lowest possible cost.

While the lending practices of many other financial institutions led to the nation's subprime mortgage debacle, data collected under the *Home Mortgage Disclosure Act* (HMDA) illustrates the value of credit unions to their communities. The difference between credit unions and banks is highlighted when one examines the 2007 *HMDA* data for loans to minority applicants with household incomes under \$40,000. According to the 2007 *HMDA* data, banks have a significantly higher percentage of mortgage purchase loans (20.8 percent), charging at least 3 percent higher than the comparable Treasury yield for minority applicants with household income under \$40,000. Credit unions, on the other hand, had only 4.4 percent of their loans in that category.

Credit Unions in the Current Economic Environment

While credit unions have fared better than most financial institutions in these turbulent economic times, many have been impacted, through no fault of their own, by the current economic environment. In particular, the corporate credit union system has felt the biggest impact and NCUA placed the two largest corporate credit unions, U.S. Central Federal Credit Union and Western Corporate Federal Credit Union, into conservatorship earlier this year. The passage and enactment

of S. 896, *The Helping Families Save Their Homes Act of 2009*, and the temporary corporate credit union stabilization fund it created, provided important relief to natural-person credit unions in these challenging times.

It is also widely recognized by leaders on Capitol Hill and in the Administration that credit unions did not cause the current economic downturn. However, we believe we can be an important part of the solution. Credit unions have fared well in the current environment and, as a result, many have capital available. Surveys of NAFCU-member credit unions have shown that many are seeing increased demand for mortgage loans and auto loans as other lenders leave the market. A number of small businesses who have lost important lines of credit from other lenders are turning to credit unions for the capital that they need. However, more can still be done.

Our nation's small businesses represent 99.7 percent of all employer firms, employ half of all private sector employees, pay more than 45 percent of total U.S. private payroll, and have generated 60 to 80 percent of net new jobs annually over the last decade. Therefore, NAFCU believes the strength of the economy is strongly influenced by the health and well-being of America's small businesses. Many small business owners are members of credit unions around the country and rely on our services to help make their small businesses successful. Our nation's credit unions stand ready to help in this time of crisis and, unlike other institutions, have the assets to do so. Unfortunately, an antiquated and arbitrary member business lending cap prevents credit unions from doing more for America's small business community.

The *Credit Union Membership Access Act* (CUMAA) established an arbitrary cap on credit union member business lending of 12.25% of assets in 1998. CUMAA also directed the Treasury Department to study the need for such a cap. In 2001, the Treasury Department released its study, entitled “Credit Union Member Business Lending,” in which it concluded that “credit unions’ business lending currently has no effect on the viability and profitability of other insured depository institutions.” The same study also found that over 50 percent of credit union loans were made to businesses with assets under \$100,000, and 45 percent of credit union business loans go to individuals with household incomes of less than \$50,000.

The current economic crisis has demonstrated the need to have capital available to help our nation’s small businesses, especially in troubling times. Many credit unions have the capital other lenders cannot provide in this current environment, but are hamstrung by this arbitrary limitation. It is with this in mind that NAFCU strongly supports the passage of H.R. 3380, the *Promoting Lending to America’s Small Business Act of 2009*. Introduced by Representatives Kanjorski and Royce, this important piece of legislation would raise the member business lending cap to 25% while also allowing credit unions to supply much needed capital to underserved areas, which have been among the hardest hit during the current economic downturn.

NAFCU also strongly supports the reintroduction of the *Credit Union Small Business Lending Act*, which was first introduced by Chair Velazquez in the 110th Congress. This bill would have exempted credit union participation in Small Business Administration (SBA) lending programs from the MBL limits currently in place. These particular programs are invaluable tools, helping many Americans to successfully start and run their own businesses.

By exempting credit union participation in these programs, small businesses throughout the nation will have greater access to capital at a time when it is needed most. We also support a continuation of the 90% guarantee on SBA loans. We view changes to allow credit unions to do more to help our nation's small businesses as an important step of reform to help our nation recover from the current economic downturn.

Financial Regulatory Reform and Credit Unions

Credit unions remain some of the most highly regulated of all financial institutions, facing restrictions on who they can serve and their ability to raise capital. There are many consumer protections already built into the Federal Credit Union Act, such as the only federal usury ceiling on financial institutions and a prohibition on pre-payment penalties others often use to trap consumers into products. However, as the current Congress and Administration mull an entire overhaul of the nation's regulatory regime for financial institutions, NAFCU feels it is important to point out the current regulatory scheme for credit unions has served the 92 million American credit union members well.

As not-for-profit member-owned cooperatives, credit unions are unique institutions in the financial services arena and make up only a small piece of the overall financial services pie. We believe the NCUA should remain the sole, independent regulator of credit unions, and are pleased to see that the Administration's proposal would maintain this independence as well as the federal credit union charter. The fact that credit unions were not the cause of the current crisis is evidence that the current regulatory framework for credit unions is working.

NAFCU also believes the Administration's proposal on regulatory reform is well-intentioned in its effort to protect consumers from the predatory practices that led to the current crisis. We feel there have been many unregulated bad actors pushing bad products onto unsuspecting consumers and we applaud efforts to address this abuse.

It is with this in mind that we can support the creation of a Consumer Financial Protection Agency (CFPA) which would have authority over non-regulated institutions that operate in the financial services marketplace. However, NAFCU does not believe such an agency should be given authority over regulated, federally-insured depository institutions, and would oppose extending this authority to federally-insured credit unions. As the only not-for-profit institutions that would be subject to the CFPA, credit unions would stand to get lost in the enormity of the proposed agency, and credit union members, as compared to stockholders and owners of other firms, will be the ones that ultimately bear the cost of this new regulator. It is with this in mind that we could also support a CFPA that did not have not-for-profits under its purview.

Giving the CFPA the authority to regulate, examine and supervise credit unions already regulated by the NCUA would add an additional regulatory burden and cost to credit unions. Additionally, it could lead to situations where institutions regulated by one agency for safety and soundness find their guidance in conflict with the regulator for consumer issues.

Such a conflict and burden will surely increase compliance costs to credit unions, leading to diminished services to their members. Credit unions already fund the budget for NCUA. The

Administration's proposal for the CFPA would also be funded by industry, meaning an additional cost burden to credit unions and their 92 million members. As not-for-profits, credit unions cannot raise money from stock sales or capital markets. This money comes from their members' deposits, meaning credit union members would disproportionately feel the cost burden of a new agency.

NAFCU is also concerned the proposal would grant the CFPA the authority to regulate mortgage, title and credit insurance. Any financial activity the agency determines is not part of the "business of insurance" would fall under its jurisdiction, including mortgage, title and credit insurance. We note that insurance is *not* an extension of credit. Instead, it protects against risk of loss. The fact that some insurance protection covers risks surrounding a credit transaction does not alter the essence of the insurance product. Given this distinction, we believe mortgage, title and credit insurance should not be included within the CFPA mandate.

However, NAFCU also recognizes that more should be done to help consumers and look out for their interests. We would propose, rather than extending the CFPA to federally-insured depository institutions such as federal credit unions, each functional regulator (such as the NCUA) for these institutions create a new or strengthened office on consumer affairs. We are pleased to see the NCUA recently announced its intention to create such an office.

We envision such an office could report directly to the Presidential appointees at the regulator and be responsible for making sure the regulator is looking out for consumer concerns in writing rules, supervising and examining institutions compliance, and administratively enforcing violations. Consumer protection offices at the functional regulators will ensure those regulating consumer

issues at financial institutions have knowledge of the institutions they are examining and knowledge and guidance on consumer protection. This is particularly important to credit unions, as they are regulated and structured differently than others in financial services, and we believe it is important for the regulator examining credit unions to understand their unique nature. We believe such an approach would strengthen consumer protection while not adding unnecessary regulatory burdens on our nation's financial institutions.

There has also been a recent proposal by Representative Walt Minnick to create a "Consumer Financial Protection and Financial Institutions Examination Council," modeled on the Federal Financial Institutions Examination Council to promote consumer protection (instead of a new CFPA). This proposal would also bolster consumer protection responsibilities of the functional regulators, along the lines of what we have outlined above. We believe that this is an idea that deserves further study and consideration.

Regulatory Reform: Executive Compensation

As not-for-profit, member-owned cooperatives the success of the credit union industry can be attributed not only to its structure and nature, but to the fact credit unions, unlike for-profit entities, are singularly focused on service to their members and do not chase stock returns. In fact, credit unions do not issue stock. Furthermore, they are governed by a volunteer board of credit union member directors, generally serving without remuneration, who ultimately decide the compensation for key employees of the credit union. It is, therefore, critical for non-profits to be treated differently than for-profit entities. Quite frankly, those running for-profit entities, including community banks, have a profit motive that can open the door for abuse, even at smaller

institutions. Those running not-for-profit cooperatives have a different motivation, which lessens the incentive for abuse.

It is with this in mind that NAFCU opposes the inclusion of credit unions as covered institutions under the recent House-passed executive compensation measure – H.R. 3269. Having the NCUA prescribe joint regulations in conjunction with other regulators who supervise for-profit, stock-issuing entities does not make sense.

Simply stated, credit unions are not guided by the profit motive or stock price manipulation which created the need for this legislation. Therefore, while NAFCU supports the underlying reform intended by this legislation, we believe credit unions should be exempt from these mandates. Credit unions were founded on the precept of “people helping people” and providing credit and thrift for provident purposes, rather than to chase large profits and astronomical bonuses.

Regulatory Reform: Community Reinvestment Act

Finally, some have advocated expanding the Community Reinvestment Act (CRA) as part of the overall regulatory reform effort. NAFCU opposes extending CRA to federal credit unions. Federal credit unions are already examples of CRA in action. CRA was adopted as a punitive measure to punish specific bad actors – namely banks and thrifts – for engaging in discriminatory practices such as redlining and disinvestment. While some say CRA was to blame for the subprime crisis, we do not believe this to be the case. Credit unions were not included under CRA because there has

never been any evidence suggesting credit unions have engaged in these illegal and abhorrent activities.

Credit unions are inherently invested in their communities, operating with a not-for-profit cooperative structure and a common bond membership, unlike other depository institutions. Credit unions embrace the unique relationship they have with their community and play an important role in providing important financial services to underserved individuals.

By law, credit unions can only take deposits and make loans to their membership. As many have wisely noted, if all financial institutions acted like credit unions, there would be no need for CRA. We firmly believe that placing CRA requirements on credit unions would create new regulatory burdens without public benefit—a solution in search of a problem.

Many credit union members come from the low-income and minority populations of our society. Although banks and thrifts are subject to CRA, HMDA data clearly indicates credit unions are outperforming banks and thrifts in terms of loan and price spreads as well as service to these particular segments of the population.

According to the 2007 HMDA data, credit unions outperformed both banks and thrifts in terms of lending to low income and minority populations, providing smaller mortgage loans, and having a higher percentage of these mortgage loans go to low- and moderate-income communities. We do not support extending CRA to credit unions and do not believe new CRA burdens should be part of any regulatory reform.

Conclusion

In conclusion, the current economic crisis is having an impact on America's credit unions, but they continue to provide excellent service to their members. NAFCU recognizes that problems and bad actors exist in the financial system and that reforms are needed. However, we believe it is important to point out that credit unions were not the cause of the current crisis and there is evidence that the regulation of credit unions in protecting their 92 million members has held up well. Credit unions stand ready to help our nation and our nation's small businesses recover from the current economic downturn and it is important that regulatory reform aid, and not hamper, those efforts.

Finally, while there are positive aspects to consumer protection in regulatory reform, we believe federal credit unions continue to warrant an independent regulator handling both safety and soundness and consumer protection matters. Moving aspects of credit union regulation away from the NCUA, to a new regulator like the CFPA, would likely increase costs and compliance burdens on credit unions. As not-for-profits, these costs are ultimately borne by credit union members. Regulatory reform should not mean new regulatory costs and burdens.

I thank you for the opportunity to appear before you today on behalf of NAFCU and would welcome any questions that you may have.